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RUEHNH  
DE RUEHGZ #3550/01 1230405  
ZNR UUUUU ZZH  
R 280621Z APR 06 ZDK CTG NUM SVCS  
FM AMCONSUL GUANGZHOU  
TO RUEHC/SECSTATE WASHDC 6827  
INFO RUEHC/SECSTATE WASHDC 6828  
RUEHOO/CHINA POSTS COLLECTIVE  
RUCNMEM/EU MEMBER STATES COLLECTIVE  
RUCNASE/ASEAN MEMBER COLLECTIVE  
RUCPDOC/USDOC WASHDC  
RUEAIIA/CIA WASHDC  
RUEKJCS/DIA WASHDC  
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UNCLAS SECTION 01 OF 04 GUANGZHOU 013550

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STATE FOR EB, R, EAP/CM, EAP/PD, DRL  
STATE PASS USTR - STRATFORD, CELICO  
USDOC FOR 4420/ITA/MAC/MCQUEEN, DAS LEVINE  
USPACOM FOR FPA

E.O. 12958: N/A

TAGS: EAIR ETRD WTRO ECON CH

SUBJECT: UPS One Year On: Despite Bumps in the Road, Big Brown Is Not Blue

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A) 05 GUANGZHOU 038410; B) GUANGZHOU 05379; C) GUANGZHOU 010672; D) 05 Guangzhou 018283

¶1. (SBU) SUMMARY: UPS officials recently discussed their experiences in South China as the company reaches its one year anniversary of direct cargo services between Guangzhou and the United States. Its China operation now wholly owned, company officials are generally positive but raised WTO-related concerns about the lack of transparency in government decisions and lawmaking, slow and onerous licensing requirements, and proposed changes to the labor and postal system laws. Despite these worries -- as well as some not-too-subtle hints from local officials about moving their hub from Shanghai to Guangzhou -- our interlocutors remain relatively upbeat about their experiences in South China and about the potential that lies ahead. End Summary.

¶2. (SBU) The Consul General and Econoffs recently met with Ken Torok, President of UPS Asia Pacific; Richard Loi, Senior Vice President, Asia Pacific Region China District; and Xiang Feng, Senior Manager for Public Affairs, China. The UPS officials requested the meeting so that Torok, who was visiting from Singapore, could meet discuss UPS' experiences in South China over the last year. It was at approximately this time last year that UPS began to offer direct cargo service between Guangzhou and the United States, via Anchorage, which was the first non-stop air service by a U.S. air carrier between Guangzhou and the United States (ref A).

One Year Later -- Going it Alone

¶3. (SBU) UPS originally entered the China market in 1988 in partnership with SinoTrans, a state-owned enterprise. After

Chinese law was changed to allow wholly-owned foreign companies, UPS announced in late December 2004, however, that it was going to take direct control of its international express operations in China's largest cities by the end of 2005 -- essentially buying out Sino Trans. UPS also planned to open offices in five major cities (Shanghai, Guangzhou, Shenzhen, Tianjin, and Qingdao) and expand to more than 20 other cities. This newfound independence, however, may be bringing some unintended consequences for UPS. Torok described how one of the toughest hurdles UPS faces in China -- the licensing process -- is not a requirement for the thousands of local courier companies which compete with UPS in the same markets.

The Licensing Hurdle: Misery Loves Company?

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¶ 14. (SBU) Torok described how, despite the fact that UPS now operates express delivery services in 23 cities, each time the company applies for a new license to operate, it has to basically start anew. He commented that to open a UPS retail store, the company needs to obtain a new and different license, even if the retail store is co-located with the delivery office, and that this process is as much work as opening an entire new city to UPS delivery services.

¶ 15. (SBU) Econoffs mentioned that these restrictions were a common occurrence in other service industries such as banking and insurance (refs B and C.) We noted that officials from these industries are anxiously looking toward 11 December 2006, after which time China's five-year WTO transition period will end and foreign service industries should theoretically be able to operate on the same terms as their domestic counterparts. We explained that representatives from those industries have told us about similar frustrations at breaking into domestic markets due to administrative hurdles such as the licensing regulation.

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(Note: Other service industry officials have told us how a long application process to open a new branch allows local governments to control the speed of expansion, and how intangible administrative measures, such as having additional capital requirements for each and every license, push up the expansion costs for foreign competitors. End Note.) The Consul General mentioned the Chinese concern with the social and economic consequences of opening up the market to foreign competitors too quickly, a factor that is undoubtedly influencing Chinese decisions on the issue.

Serious Concerns About Proposed Labor Law:  
A French Model in the Works? Bad News.

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¶ 16. (SBU) The conversation then turned to a discussion of the draft of a proposed labor law, which many observers see as a mis-guided government attempt to offer more protection to workers, many of whom have been displaced during China's vast economic reforms. Critics -- among them many Western multinational companies who are voicing their concerns to the government via the protective cover of business associations -- have said the draft new law will severely limit employers' flexibility to hire and fire employees; gives unions considerable input over personnel decisions; requires excessive severance payments in certain cases; and bans service agreements which allow temporary employment. The temporary worker provision converts temporary workers to fully-vested workers after a short time of working temporarily for a company. The target date to finish the draft legislation is 2007 and the legislation is currently open for public comment.

The Government as Union

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¶ 17. (SBU) Torok commented rhetorically that under his

interpretation of this new law, labor unions would not be necessary because the government would take their place with the provisions of this proposed law. The Consul General commented, and Torok readily agreed, that perhaps rather than "reinventing the wheel" with a new law, a better approach would be for China to simply enforce its current labor laws, which most experts find to be quite comprehensive, at least on paper.

¶8. (SBU) Loi commented that in his experience, UPS employees are happy working for UPS without labor union representation because the company respects them and meets their needs. Loi continued that the company celebrates holidays and cultural events with its employees; for example, giving employees moon cakes during the Mid-Autumn festival. He commented that he has heard that Taiwan companies in particular, take advantage of their workers, paying only the minimum wage, despite requiring overtime work. He opined that the growing number of labor protests attests to the fact that there are many workers who are unhappy with their employers.

No Express Delivery of New Postal Law, But Concerns Remain

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¶9. (SBU) The discussion then turned to efforts to rework China's postal law. (Note: China has been working to reform its existing postal law, enacted in 1986, for more than seven years. Drafting of the reform package began in 2003, but the law became bogged down by the slow pace of the amendment process. In the meantime, many foreign companies, such as UPS, remain concerned about the possible impact of a new law on their business. End Note.) Torok said that while he was somewhat heartened by a statement that Vice Premier Wu Yi made during the April 11 Joint Commission on Commerce and Trade (JCCT) meeting in Washington, DC, -- in which she reportedly said that the regulatory environment for express services for foreign companies would not be negatively effected by new rules, including by postal reform

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-- UPS still has several concerns about the new law. These include: the universal postal fund, which UPS sees as a form of double taxation; the law's definition of a monopoly, with which UPS does not agree; a proposal to make the State Postal Bureau (SPB) a regulator for the whole industry -- since the SPB is a direct competitor UPS would like to see an independent regulator; and the treatment given to domestic firms, which UPS believes comes at the expense of foreign companies and would violate WTO national treatment rules.

¶10. (SBU) One example Torok provided highlighted several concerns at once. While the central government has declined to provide firms with copies of the draft laws, UPS has managed to acquire an unofficial copy. Torok explained that as he understands it, the 7th draft of the law allows foreign companies to only provide express services, which the industry regulator (i.e. its competition, the China Post) would define, presumably in a way that would suit its own business needs. Torok explained that UPS has heard from its sources that the Chinese government may have decided to discard this point because it violates WTO, but he said UPS does not know for sure -- underscoring a complaint he made earlier about how the companies that will be affected by the new law have little knowledge about the decision making process and no opportunity to comment on it.

¶11. (SBU) Torok noted that according to another senior UPS official, postal reform may be put on hold, however, as Chinese legislative priorities have reportedly changed and postal reform is less of a priority. It has reportedly been pushed into the background by a new interest in promoting a limited partnership law. According to this UPS official, the draft postal law is not yet out of the State Council and it is uncertain if it will go to the National People's

Congress by the end of the year.

¶12. (SBU) Econoff addressed Torok's concerns about the SPB becoming the industry regulator by noting that if past experience in the banking and insurance industries is any indication, the Chinese government may recognize that this is a conflict of interest. In both of those industries, the initial plan was to use regulators who were direct competitors in the industry. However, the Chinese realized the problems inherent in this plan and eventually separated the functions.

So Now That You Are Here, When Are You Moving Your Hub?  
Guangzhou Hints at Favors

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¶13. (SBU) Torok noted that as part of his visit to Guangzhou he was making the rounds to call on various Chinese officials. Torok commented that when meeting with the Guangzhou Party Secretary General and with one of the Vice Mayors, he was asked with the bluntness characteristic of many Chinese officials "so when are you moving your China hub from Shanghai to Guangzhou?" (Note: This was in obvious reference to the July 2005 deal Fedex signed to establish its Asia Pacific hub at Guangzhou's Baiyun Airport (ref D) -- a coup for local officials considering the estimated USD 60 billion economic benefit the hub will bring to the region. End Note.) Officials noted that some current frictions -- slowness in licensing and Customs clearances and additional fees (see below) that UPS objects to -- could all be dealt with if UPS would move its headquarters to Guangzhou. Torok replied that Guangdong Province is UPS' operational headquarters, and the company is continually injecting more money here -- more than USD 100 million this year alone, in part due to capital requirements for new licenses. Torok also met with the Vice President of the Baiyun Airport Authority, with whom he raised concerns about additional fees UPS must pay their handling agent for ground handling inside their own express handling unit and fees due to stationing of government officials within the building -- fees UPS does not pay

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anywhere else in the world.

Comment: Speed Bumps Not Bad but Not Fair

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¶14. (SBU) Despite the issues of concern that Torok raised during the meeting, he was, on the whole, upbeat about UPS' experiences thus far in South China. The opening of the logistics and postal express markets under China's WTO accession agreement acted as a strong lure for UPS to come into South China, and this lucrative market is still very much within UPS' sights. UPS officials are seasoned businesspeople who seem to understand that there will be bumps on the delivery route, but that once UPS can overcome these speed bumps, a vast market anxious to take delivery of UPS' professional services lies ahead. Nonetheless, UPS believes China should keep to the spirit of the WTO rules and let competition flourish without putting obstacles in its way.

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